JOINT FAQs Related to the Perspectives Blog, “Keeping What Works: How the GSEs are Protecting Homeowners, Taxpayers, and the Industry”

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Q1: Why is a replacement cost value (RCV) policy important and why isn’t an actual cash value (ACV) policy permitted?

An RCV policy provides borrowers with more financial protection. ACV policies provide substantially less coverage to homeowners at the time of a loss, usually resulting in much larger out of pocket expenses to repair their home. For homeowners who may not have financial means, this can lead to increased debt, incomplete repairs, and even dangerous living conditions.

Allowing for properties secured by GSE mortgages to have less insurance coverage increases credit risk, particularly after disasters. These long-established requirements not only help protect the safety and soundness of our companies, mortgage lenders and servicers, and U.S. taxpayers, but importantly, help protect homeowners themselves.

Q2: What’s the difference between policies that settle losses at RCV versus ACV?

An RCV policy (also known as replacement cost coverage or replacement cost loss settlement), will settle claims without a deduction for depreciation, subject to the policy limit. RCV policies help ensure the borrower will be able to repair or replace the damaged portion of the insured property with material of like kind and quality. In other words, it usually reduces the amount that the borrower will have to pay out of pocket after a loss.

In contrast, an ACV policy will settle losses by calculating the cost to repair or replace the damaged property, with a deduction for depreciation. This means the borrower will nearly always receive a lower payout than if the policy settled losses on a replacement cost basis, thus reducing the amount of money available to repair or replace the damaged property. In most cases, an ACV policy will require a borrower to pay a greater portion of the loss amount out of pocket to repair the property. For example:

> The Smiths have an **RCV** policy, meaning once the roof is replaced, they will be reimbursed the full cost of the roof repair, minus their deductible. The Johnsons have an **ACV** policy, meaning they will only be paid for the current value of the roof repairs, minus depreciation and their deductible. The breakdown of their payments is below.

Family	**Damage**	**Depreciation**	**Deductible**	**Payment**
Smith Family	$15,000	- n/a	- $1,000	= $14,000
Johnson Family	$15,000	- $10,000	- $1,000	= $4,000

Source: https://content.naic.org/article/rebuilding-after-storm-know-difference-between-replacement-cost-and-actual-cash-value-when-it-comes

Q3: What is RCV?

RCV is the estimated dollar amount necessary to rebuild the insured property with material of like kind and quality after a total loss. Obtaining the RCV is a critical element in confirming a policy meets our minimum coverage amount requirements. Though it has a similar name, RCV is not the same as an RCV policy.

Q4: Why do lenders and servicers need to know the replacement cost value to rebuild a home?

The GSEs' requirements provide guidance on the minimum coverage limits required. On a typical single-family home, the minimum required coverage limit is calculated based on two important factors: the total RCV of the property and the unpaid principal balance (UPB) of the mortgage. Depending on these amounts, the requirement can be one of three values, which is determined by a simple formula. Without both values, it is impossible to determine whether the policy meets the GSEs' requirements for the minimum coverage amount.

Here is an example:

	Property A: **The RCV is less than the UPB**	**Property B:** **80% of the RCV is equal to or less than the UPB**	**Property C:** **80% of the RCV is Greater than the UPB**
RCV	$90,000	$90,000	$90,000
UPB	$100,000	$80,000	$65,000
80% of Replacement Cost	$72,000	$72,000	$72,000
Required Insurance Coverage	**$90,000**	**$80,000**	**$72,000**

It is important to note that the market value of the property is not utilized in determining the minimum insurance requirements. Market values incorporate the value of the land, which is typically not covered in a homeowners insurance policy.

Q5: What was the purpose of the February 2024 Selling and Servicing Guide communications, regarding insurance requirements?

The February 2024 Guide clarifications reinforced lenders' and servicers' responsibilities to ensure that properties are covered by required insurance as part of our efforts to promote sustainable homeownership. This included clarifications to two key longstanding requirements in our Guides – first, that claims must be settled on a replacement cost basis, and second, that the estimated RCV is needed to determine whether the coverage amount meets the GSEs' minimum coverage amount requirements.

It is critical that homeowners have sufficient property insurance coverage so they can repair their homes and recover financially following a disaster or other insured loss. The need for sufficient property insurance coverage is a goal that is shared by investors, lenders, servicers, and insurers alike. The GSEs' long-standing property insurance requirements are critical in helping protect millions of homeowners, especially as natural disasters continue to increase in frequency and severity.

Q6: Did the GSEs change their requirements related to ACV policies?

No, the GSEs did not make changes related to the unacceptability of ACV policies in the February communications. Neither GSE allowed ACV policies prior to the February communications. The GSEs continue to engage with industry partners to hear their concerns.

Q7: Do the GSEs' insurance requirements impact insurer claim handling practices?

No, the GSEs' insurance requirements do not address or impact insurers' claim handling practices.

Q8: Did the GSEs change their coverage amount requirements?

No, the GSEs did not change their long-established requirements for determining the required property insurance coverage amount.

Q9: What was the purpose of the May 8, 2024, GSE communications?

The purpose of the GSEs' joint communications on May 8 was to address subsequent industry feedback and concerns related to obtaining the RCV and to reinforce the importance of the GSEs' property insurance requirements. We communicated that while we conduct industry outreach and engagement to further understand the concerns, we will not cite findings for certain noncompliance related to obtaining the RCV for the purposes of determining coverage amount sufficiency.

Q10: How long will the GSEs refrain from citing findings for non-compliance related to obtaining property insurance replacement cost values?

As outlined in our respective May 8 communications, the GSEs will refrain from citing applicable findings while we conduct industry outreach and explore solutions to ensure lenders and servicers can comply with our insurance requirements. Lenders and servicers' responsibilities to ensure the property is adequately insured remain unchanged. We will communicate any applicable updates at a future date.

Q11: Do the May 8 communications apply to flood insurance?

No, the May 8 communications did not impact the GSEs' existing flood insurance requirements. Lenders and servicers are still required to comply with all applicable state and federal laws.

Q12: In light of the GSEs' May 8 communications, do lenders and servicers still need to check insurance to ensure it meets GSE requirements?

Yes, lenders' and servicers' obligations to ensure the property is adequately insured in accordance with the GSEs' respective Guides remain unchanged. We expect lenders and servicers to continue with their processes and make best efforts to confirm the adequacy of property insurance coverage while we engage in industry outreach.

Q13: Have lender or servicer representations and warranties changed as a result of the May 8, 2024, communications?

No, lenders' and servicers' obligation to indemnify the GSEs remain unchanged with respect to a loss resulting from insufficient property insurance coverage.

Additional Resources:

- Fannie Mae's May 2024 Selling and Servicing Notice
- Freddie Mac's May 2024 Industry Letter
- Fannie Mae's February 2024 Selling and Servicing Guide Updates
- Freddie Mac's February 2024 Selling and Servicing Guide Bulletin Updates
- Perspectives Blog, "Keeping What Works: How the GSEs are Protecting Homeowners, Taxpayers, and the Industry"